In the United States Bankruptcy Court
for the
Southern District of Georgia
Savannah Division

In the matter of:

SANDRA MARLENE DELOACH

Debtor

Chapter 7 Case

Debtor 92-41320

MEMORANDUM AND ORDER ON TRUSTEE'S APPLICATION TO EMPLOY SPECIAL COUNSEL

The Chapter 7 Trustee, James L. Drake, Jr., filed an application on July 22, 1993, to employ Richard H. Middleton, Jr., and Peter C. Adams of the law firm of Middleton & Mixson, P.C., as special counsel to represent the Debtor, Sandra Marlene Deloach, in two separate civil actions pending in the United States District Court for the Southern District of Georgia, styled Deloach v. Provident Health Services, Inc., et al. No. CV493-120, and Deloach v. Dow Corning, et al., No. CV493-232. An objection to the Trustee's application was filed on July 30, 1993, by a creditor of the estate, Memorial Medical Center ("MMC"), and Hilb, Rogal and Hamilton Employee Benefits, Inc. ("HRH"). A hearing to consider the objection was held on August 24, 1993.

FINDINGS OF FACT

The evidence at the hearing revealed that the Debtor's case was filed as a no-asset case, and the existence of these two pending civil actions was not revealed in the Debtor's schedules as required by the Bankruptcy Code. Upon the Trustee's discovery of the pendency of the lawsuits, an application to reopen the case was filed, and this Court, on July 20, 1993, entered an order reopening the case in order for the Trustee to pursue the previously undisclosed litigation on behalf of the creditors of the estate.

The Trustee's application to employ Messrs. Middleton and Adams asserts that they are the attorneys of record representing the Plaintiff in the pending District Court civil actions and that their employment is desirable because of their existing familiarity with the facts and issues in the cases and their expertise in litigation of the type involved in the pending suits. The application further asserts that the attorneys "are not disqualified for such employment by applicant because of their representation of the Debtor, since as appears from the declarations of Messrs. Middleton and Adams, they do not hold or represent any interest adverse to the Debtor or the Trustee in this estate with respect to the special matters upon which

they are to be employed." Attached to the application are affidavits individually signed by Messrs. Adams and Middleton which, as alleged by the Trustee, do represent that the attorneys do not hold or represent any interest adverse to the Debtor or the estate.

The court inquired of the parties whether the proposed special counsel Messrs. Middleton and Adams participated in the decision of the Debtor when she failed to disclose the pendency of these causes of action in the filing of her Chapter 7 case. It is clear from the record that another attorney represented Debtor in the filing and prosecution of her Chapter 7 petition and the parties advised the court that they had no information to suggest that Messrs. Middleton or Adams were culpable in Debtor's failure to disclose these causes of action in the bankruptcy proceeding.

Nonetheless, MMC and HRH contend that there is a conflict of interest in Messrs. Middleton and Adams being employed to represent the interest of the Trustee while continuing to represent the interest of the Debtor in the prosecution of these actions. At the hearing of August 24, 1993, MMC and HRH argued that the Debtor's failure to disclose the pendency of these causes of actions should judicially estop the Debtor from any recovery and that it is inconsistent for Messrs. Middleton

and Adams to continue to represent the Debtor in her efforts to overcome that estoppel argument and to represent the interest of the Trustee who has the right to continue to prosecute the action independent of the Debtor.

Since the hearing before this court, the Honorable Anthony A. Alaimo, United States District Judge for the Southern District of Georgia, entered an Order on September 1, 1993, dealing with the judicial estoppel issue. In Judge Alaimo's Order, he ruled that the Debtor is no longer the real party in interest because the claim became the property of the bankruptcy trustee when Debtor commenced her Chapter 7 case. Accordingly, Judge Alaimo declined to grant summary judgment against the Debtor under principles of judicial estoppel since the bankruptcy trustee was the proper party in the civil actions before him. Judge Alaimo concluded that the Trustee could and should continue to pursue this action.

> . . . . It would be grossly unfair to Deloach's creditors to reduce the bankruptcy trustee's rights because Deloach kept information from the bankruptcy court. By pursuing this suit, the bankruptcy trustee is seeking to rectify any injustice caused by the omission; he is not asserting an inconsistent position for the purpose of gaining an unfair advantage.

Judge Alaimo's Order makes clear that the Chapter 7 Trustee is the only remaining Plaintiff in the two actions pending in the District Court, and Debtor no longer possesses any direct interest in the litigation. The only remaining issue, then, is whether Debtor possesses an interest in the litigation, through her bankruptcy case, which creates a conflict of interest for Messrs. Middleton and Adams.

CONCLUSIONS OF LAW

Judge Alaimo's Order of September 1, 1993, did not deal with the issue of whether Debtor remains eligible to participate in any recovery from the lawsuits as a result of any distribution in her bankruptcy case. Thus, while it is clear that Debtor has no standing to participate directly in any recovery from either of the lawsuits pending in the District Court, the issue of her eligibility to share in the recovery within her bankruptcy case remains unresolved.

11 U.S.C. Section 726(a)(6) provides that any surplus property, which remains after all other estate claims have been satisfied, shall be distributed to the debtor. In this case, the recovery in these pending lawsuits has the potential to substantially exceed the sum of the creditors' claims against Debtor's estate. Debtor

would ordinarily be entitled to this excess under of section 726(a)(6), and consequently, would have standing in the bankruptcy case to raise objection to any settlement proposed by the Trustee.

The court is aware that Debtor's ability or eligibility to participate in any recovery under section 726(a)(6) is unclear due to her failure to disclose the lawsuits when she filed her Chapter 7 petition. That issue, however, is not before the court and such a determination is left for a later date. Therefore, I conclude that, for the purposes of this Order, Debtor continues to possess an interest in the lawsuits by virtue of section 726(a)(6).

Having concluded that Debtor does retain, at least nominally, an interest in the pending litigation under Section 726(a)(6), it is not difficult to envision a scenario where the Debtor would disagree with the Trustee's proposed settlement of the litigation. For example, at some stage in the litigation, the Trustee may wish to accept a settlement offer which is only sufficient to satisfy the claims of creditors of the estate, leaving little or nothing for the Debtor under section 726(a)(6). Such a scenario is not unlikely. The type of litigation involved in these two lawsuits is expensive and the outcome uncertain. If the Trustee received a settlement offer which

is sufficient to satisfy all of the claims in the estate, he may judge the offer to be in the best interests of the estate, given the costs, delay and risks of further litigation.

Debtor's interest, on the other hand, would be diametrically opposed to that of the Trustee's. Debtor is entitled to nothing under section 726(a)(6) unless the settlement exceeds the sum of all claims in the estate. Moreover, she would be entitled to all of the recovery in excess of all claims in the estate, no matter how large. Thus, Debtor would naturally be willing to accept the greater costs and risks of continuing the litigation in hopes of recovering a greater sum of money.

Under such a scenario, Messrs. Middleton and Adams would find themselves in a compromising position if they represented both the Trustee and Debtor. As counsel for Trustee in the pending litigation, they would be bound to follow his instructions and accept a settlement offer, but if they also remain counsel for Debtor they would potentially be motivated on her behalf to dissuade the Trustee from a settlement to which she objected. It is apparent, then, that a potential conflict of interest would exist for Messrs. Middleton and Adams if they undertook representation of the Trustee while still representing Debtor.

Canon 5 of the Georgia Code of Professional Responsibility provides that "A Lawyer Should Exercise Independent Professional Judgment on Behalf of a Client." Under Canon 5, there are two Ethical Considerations, EC 5-14 and 5-15, and two Directory Rules, DR 5-105(A) and (C), which bear directly on this issue. EC 5-14 provides:

> Maintaining the independence of professional judgment required of a lawyer precludes his acceptance or continuation of employment that will adversely affect his judgment on behalf of or dilute his loyalty to a client. This problem arises whenever a lawyer is asked to represent two or more clients *who may have differing interests*, whether such interests be conflicting, inconsistent, diverse, or otherwise discordant.

EC 5-15 provides, in part:

> If a lawyer is requested to undertake or to continue representation of multiple clients having potentially differing interests, he must weigh carefully the possibility that his judgment may be impaired or his loyalty divided if he accepts or continues the employment. He should resolve all doubts against the propriety of the representation. A lawyer should never represent in litigation multiple clients with differing interests; and there are a few situations in which he would be justified in representing in litigation multiple clients with *potentially differing interests*. . .

DR 5-105(A) provides:

> A lawyer *shall* decline proffered employment if the exercise of his independent professional judgment in behalf of a client will be or is likely to be adversely affected by the acceptance of the proffered employment, except to the extent permitted under DR 5-105(c).

DR 5-105(C) provides:

> In the situation covered by DR 5-105(A) . . ., a lawyer may represent multiple clients if it is obvious that he can adequately represent the interest of each and if each consents to the representation after full disclosure of the possible effect of such representation on the exercise of his independent professional judgment on behalf of each.

Ethical Considerations are not mandatory, but provide general ethical guidelines to be considered in interpreting and applying the Directory Rules, which are the mandatory provisions of the Code. EC 5-14 and EC 5-15 make clear that there is a strong presumption against the representation of multiple clients with potentially conflicting interests, particularly in matters related to litigation. DR 5-105(A) directs a lawyer to refuse employment which might adversely affect the exercise of his independent professional judgment. This provision clearly contemplates

that if a conflict of interest is foreseeable, a lawyer should decline proffered employment. DR 5-105(C) creates an exception to the rule stated in DR 5-105(A) when two conditions are present:

> 1) It is obvious that the lawyer can adequately represent the interest of each client; and
>
> 2) Each client consents to the representation after full disclosure of the possible effect of such representation on the exercise of the lawyer's independent professional judgment on behalf of each.

The exception set forth in DR 5-105(C) is inapplicable to the case at bar because it is not obvious that Messrs. Adams and Middleton can adequately represent both the Trustee and Debtor. As the above discussion illustrates, *see* discussion *supra* pp. 6-7, the potential conflict of interest which would exist if Messrs. Adams and Middleton undertook representation of both the Trustee in the pending litigation and Debtor in her bankruptcy case could place Messrs. Adams and Middleton in an untenable position. Therefore, I conclude that Messrs. Adams and Middleton are prohibited under DR 5-105(A) from undertaking representation of the Trustee while Debtor remains their client. The creditors' objection to the Trustee's application is therefore sustained. However, the bar is not absolute. Messrs. Adams

and Middleton may, within the confines of any applicable ethical standards[1] or local court rules,[2] elect to represent either the Trustee or the Debtor in this matter, but may not represent both. Since they are otherwise qualified to serve they will be approved as counsel to the Trustee should the only reason for their disqualification be removed within thirty (30) days. Otherwise the application is denied.

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia
This 25th day of October, 1993.

[1] *See e.g.* Georgia Code of Professional Responsibility, DR 2-110, Standard 44. Debtor is unlikely to be prejudiced by Messrs. Adams and Middleton's withdrawal since she is no longer a party to either lawsuit and is represented by other counsel in her bankruptcy case.

[2] *See e.g.* Rules 6 & 7 of Section IV of the Local Rules of the United States District Court for the Southern District of Georgia (made applicable to the Bankruptcy Court by Order entered on October 26, 1989).